

Paper Trail: Working Papers and Recent Scholarship

Editor's Note: Bill Page's review covers a topic ripped from today's headlines: John Lopatka's argument that decisions by sports standards-setting bodies on equipment standards or specifications should be per se legal under the antitrust laws. And John Woodbury looks to a recent FTC Report by Malcolm Coate and Andrew Heimert that reviews how the FTC staff have evaluated efficiency claims for guidance on what kinds of hurdles must be overcome to convince the FTC staff to accept an efficiency claim. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Recent Papers

John E. Lopatka, *Antitrust and Sports Equipment Standards: Winners and Whiners*

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413172

In this paper, John Lopatka¹ argues that decisions by sports standards-setting bodies should be per se legal under the antitrust laws. (He does not discuss whether similar reasoning would apply to other standards-setting bodies, because the economic circumstances, composition, and incentives of those bodies are too diverse to permit that kind of generalization.) To focus the discussion, he distinguishes equipment standards or specifications, which are the subject of his argument, from rules of the game.² Equipment standards “prescribe the attributes of physical inputs that participants in the sport are permitted or required to use” (e.g., “[t]he bat shall be one piece of solid wood”). Rules, instead, define how the game is played (e.g., “[a] batter is out when [h]is fair or foul fly ball . . . is legally caught by a fielder”). Standards, he notes, “can dramatically affect performance” on the field, but can also determine which products survive in the market because “[s]tandards inherently exclude” to the extent the sport’s participants accept them. As a result of their economic importance to sports equipment manufacturers, standards decisions often provoke antitrust suits by losers, usually alleging a boycott by the standards-setting agency in league with the winning producers. Although the suits are rarely successful, Lopatka argues that courts have failed to grasp the economics of sports equipment markets and therefore have analyzed the legal issues incorrectly.

Lopatka observes that sport is a form of entertainment for both spectators and participants. Its value to these groups depends on “comparative performance” not only among contestants in individual games and over a season, but also among players and teams in different seasons over decades. (Hall-of-famers are players who have won the “long-term” competition by breaking records and passing other benchmarks of performance.) Leagues and their constituent teams

¹ Professor Lopatka is my frequent co-author, but *Winners and Whiners* is exclusively his work.

² Both, of course, are forms of rules that would be included in the sport’s rule book. The point of the distinction is apparently to highlight norms that affect manufactured inputs, and therefore are likely to have economic consequences off the field of play. There is no suggestion that “rules,” under this distinction, would be subject to stricter antitrust scrutiny.

derive income from the value that spectators place on this competition. Equipment manufacturers also derive income from the value that participants place on the competition and their attendant demand for the best compliant equipment. It is in this last context that standards are crucial: “[e]quipment standards become important as physical exertion combines with inanimate inputs to affect outcome.” Because contestants derive value from their relative performance with others, they are willing to pay for equipment that improves their performance. That willingness to pay creates an incentive for equipment manufacturers to innovate both within and outside existing standards. Where their equipment pushes or exceeds the limit of existing standards, a standards-setting body may have to decide whether the products should be approved for officially sanctioned events.

The standards-setting body does not necessarily want to maximize the performance of athletes or the profit of equipment manufacturers. Its incentive, Lopatka notes, “is to maximize the value of the sport subject to the constraint of an acceptable level of participant safety,” a goal that sometimes requires it to prevent innovation. If, for example, someone invented shoes that increased the speed of base runners by 30 percent, base stealing might become so easy that the game would be compromised. Metal bats in the hands of major league hitters would raise similar issues. The standards-setting body then would be required to redefine equipment standards to preserve the value of the game.

A standards-setting agency is an agent of the participants to establish uniformity in the characteristics of their equipment. Uniformity is valuable because it assures fairness in head-to-head competition and over the course of a season. It may also assure that records of human performance retain some meaning across eras—what Lopatka calls long-term competition. But Lopatka’s most important point is that uniformity in equipment standards increases value by creating positive network effects, or scale economies on the demand side. Rules and standards, Lopatka observes, define a network of players who comply with the standards. In golf, for example, this group includes not only Tour players, but duffers who want assurance that their competitors are playing the same game, with standards-compliant equipment. Players and spectators receive direct network benefits as the size of the network grows, because there are more and presumably better players to compete against or to watch. The players also receive indirect network benefits, because a large number of participants spurs manufacturers to produce more and better compliant equipment. Thus, golf club manufacturers will produce clubs that comply with standards that most golfers accept; and, by the same token, golfers “will tend to adopt the set of golf rules and standards for which the greatest array of clubs [is] available.” This positive feedback loop may result in tipping toward one standard, or (if network effects are exhaustible) multiple standards may emerge for different versions of a sport. Once standards are established, they are likely become locked in to some extent because of the costs to contestants of buying new equipment. A standards-setting body may even choose to reject a standard that makes conforming equipment so expensive that few can afford to play the game.

Lopatka observes that manufacturers’ challenges to standards decisions rest on an implicit assertion that the standards-setting body deliberately chose to reduce the value of its sport. Whether a particular decision actually reduces or enhances the sport’s value is virtually impossible to resolve convincingly on a factual level. An innovation that improves performance may be good for the players that take advantage of it, but bad for the sport over the long term; the calculation of which effect predominates is likely to be difficult and impressionistic. Consequently, Lopatka argues that the issue should be resolved categorically based on the incentives of the standards-setter. Under that approach, he concludes that per se legality should follow.

A standards-setting agency has no incentive to reduce the value of its sport, unless it derives revenue from sale of the affected equipment or receives side payments from equipment manufacturers. Lopatka argues that even in the latter case decisions of the standards-setting body do not offend antitrust law, because it is only exercising lawfully acquired market power. “The relevant market,” Lopatka notes, “is defined by the purchase decisions of those buyers who adhere to the governing body’s standards.” The body thus has market power only to the extent participants (or “sports society members”) choose to accept its decisions. If a decision—as an example, to use only wooden bats in minor league baseball—reduces overall welfare, the standards-setting body suffers a loss for that. The body cannot prevent anyone from producing a product; it can only affect the purchase decisions of those who accept its authority, either because they play in sanctioned events or because of network effects—both lawful forms of market power. As Lopatka puts it, “The market, not antitrust, provides the necessary sanction” to limit abuses.

In theory, Lopatka recognizes, players or society members who do not accept the decision of the governing body might be harmed if the decision denied minimum efficient scale to the producers of the non-complying equipment. For example, golfers who want to use clubs that are banned for professional players might have to pay more if the standard reduces demand so much that the producers of those clubs cannot sell enough of them to produce at an efficient scale. But Lopatka argues that this scenario is unlikely—there is no case in which the argument has even been made. Similarly, Lopatka recognizes that it would be unlawful for a standards-setting body to adopt (or fail to adopt) a standard under the threat of incumbent equipment suppliers to withhold sales of their products. But, he notes, “no reported case suggests this kind of supplier coercion.”

Lopatka suggests that equipment manufacturers may be able to protect investments in new technology by contracting with sports governing bodies. He gives the example of Speedo, which consulted continuously with international swimming authorities in the development of its LZR Racer suit that Michael Phelps and others wore in the 2008 Olympics. As that very example shows, however, even extensive consultations will not bind the agency to accept innovations. FINA, swimming’s international standards-setting body, voted in July 2009 to ban high-tech non-textile suits starting in 2010. Thus, the risk will evidently remain that the standard-setting body will eventually find innovations detrimental to the sport, rendering the investments in developing the new equipment worthless.

In a concluding section, Lopatka reviews the classic boycott cases, showing how their standards opened the door for the arguments in sports equipment cases. *Northwest Wholesale Stationers*,³ *Indian Head*,⁴ and *Discon*⁵ now make clear that virtually all sports standards cases should be judged under the rule of reason. In his review of recent sports equipment cases, Lopatka is particularly critical of courts’ insistence that governing bodies justify their decisions based on the integrity of the game, even under a deferential standard. He notes that this requirement places the burden on standards-setting bodies to justify decisions banning new technologies to the detriment of the innovators and to justify decisions approving new technologies to the detriment of existing producers. He notes that, at one point, the NCAA simultaneously had to defend against suits by manufacturers of both wooden bats and aluminum bats, each group

³ *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284 (1985).

⁴ *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988).

⁵ *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998).

claiming the NCAA had conspired with the other to establish standards detrimental to the game. Lopatka endorses the approach of one court that held that, unless a standards-setting agency's decision was "corrupted by coercion from competitors of the disadvantaged buyer," the court "need not be concerned with the rationality or fairness" of the agency's decision.⁶ This rule is not far from Lopatka's preferred standard of per se legality.

—WHP

Malcolm B. Coate and Andrew J. Heimert, Merger Efficiencies at the Federal Trade Commission 1997–2007 (FTC Bureau of Economics Feb. 2009)

<http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf>

In a recent *Paper Trail*,⁷ we summarized and discussed a methodology to evaluate mergers in differentiated product industries proposed by Joe Farrell and Carl Shapiro—now the chief economists for the FTC and Antitrust Division, respectively. That proposal focused on comparing what Farrell and Shapiro call the "cannibalization" tax that could result from the merger with the anticipated efficiencies from the merger to determine whether, on balance, the merger will create upward pricing pressure.

In brief, the cannibalization tax can be thought of as the profits forgone by the firm when an increase in the sales of good 1 comes at the expense of another good 2. When the two goods are sold by independent firms, the tax is zero for the firm producing good 1, since the displacement increases its profits by the margin on the units of good 1 sold for every unit of good 2 displaced. But if these two firms now merge, the merger reduces the profitability that would otherwise result from lowering the price of good 1. This is because some of those increased sales of good 1 at the lower price "cannibalize" the sales of good 2. That is, some of the increased sales of the units of good 1 displace the sales of good 2 units. The forgone profits on the displaced sales of the good 2 units now become an additional cost to the merged firm when it sells more of good 1. Thus, in effect, the merger results in an increase in the marginal costs of producing and selling good 1 and so (other things equal) the post-merger incentive to reduce prices is lower than the pre-merger incentive. If that increase in marginal costs is greater than the anticipated efficiency gain from the merger, then the net increase in costs results in upward pricing pressure for good 1.

Farrell and Shapiro argue that this upward pricing pressure should generate a rebuttable presumption that a merger will increase prices. In this way, Farrell and Shapiro have brought efficiencies to the forefront of merger analysis (at least in differentiated product mergers) because one way to rebut that presumption is to demonstrate that merger-specific efficiencies are more substantial than believed by the agencies. A key question, then, is what hurdles must efficiency defenses overcome to be credible and thus acceptable to the agencies?

With what now may be a renewed focus on efficiencies, a recently released FTC Report authored by FTC staffers Malcolm Coate and Andrew Heimert (C/H) is timely. Their Report, *Merger Efficiencies at the Federal Trade Commission 1997–2007*, reviews how the FTC staff have evaluated efficiency claims during that period and may shed some light on what kinds of hurdles must be overcome to convince the FTC staff to accept an efficiency claim. Key among its conclusions

⁶ *Brookins v. Int'l Motor Contest Ass'n*, 219 F.3d 849, 853–55 (8th Cir. 2000).

⁷ *Paper Trail: Working Papers and Recent Scholarship*, ANTITRUST SOURCE, Dec. 2008, at <http://www.abanet.org/antitrust/antitrustsource/08/12/Dec08-pTrail12-22f.pdf> (reviewing Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition* (Nov. 28, 2008), available at <http://faculty.haas.berkeley.edu/shapiro>).

(which I explore in further detail here) are the importance of merger specificity and verifiability to the staff's evaluation of the efficiencies claim. C/H also compare the differing views of the staffs of the Bureau of Competition (BC) and Bureau of Economics (BE) regarding other reasons to reject efficiency claims.

While this Report was released to the public after President Obama had taken office, it was approved by the Commission while William Kovacic was still Chairman. Although it is possible that the new Democratic leadership at the antitrust agencies will increase the height of the hurdles for agency acceptability of efficiency claims, the C/H Report is nonetheless useful in identifying what those hurdles have been and are likely to be.

C/H compiled the data used for the evaluation from FTC files based on recommendations to the Commission made by the BE staff and the BC staff, as discussed in more detail below. The data compilation spanned the period from April 1997 to March 2007. They made this timing choice in light of the expanded discussion of efficiency defenses adopted by the 1997 revisions to the Horizontal Merger Guidelines.⁸ As C/H describe, those revisions included an emphasis on the parties' burden to demonstrate the verifiability of claimed efficiencies, the absence of practical alternatives to merger to attain them, and that the cost savings would not result from post-merger output reductions. In addition, the revisions indicate that any efficiencies must be shown to be sufficiently large to outweigh any merger-induced tendency to increase price.

In what follows, I am generally faithful to the authors' story but will emphasize and characterize some points differently than C/H. Much (but not all) of their Report focuses on differences in how the BC and BE implemented the 1997 Guidelines revisions. I instead choose to focus on the extent to which merger efficiencies seemed important to the antitrust analysis at the FTC. In addition, I focus more particularly on the kinds of concerns that the two Bureaus expressed about the claimed efficiencies, a focus that is more relevant for antitrust practitioners and is somewhat diluted by the BC versus BE discussions in the Report.⁹

At the outset, it is worth asking whether the FTC staff takes efficiency claims seriously—that is, does it pay more than just lip-service to those seemingly self-serving claims of the merging parties. C/H reviewed fifteen “white papers” submitted by merging parties that had been retained by the staff in their files (most of the white papers were apparently destroyed or otherwise unavailable) and identified a total of fifty-eight efficiency claims made by the merging parties. All but seven of those claims were considered by the staff. So that's the good news—the staff does consider those claims.

The next question, then, is how many of those claims were accepted by the staff. The news there is not as good. C/H reviewed the BC and BE staff memoranda to the Commission for 147 transactions for which a second request was issued and for which efficiencies were discussed in the staff memoranda. The BC memoranda identified 342 distinct efficiency claims and the BE memoranda identified 311 such claims. BC accepted 8 percent of those claims while BE accepted 27 percent of the efficiency claims. (C/H Tables 2 and 3.) For the majority of claims, neither Bureau

⁸ There may be a concern that reviewing the experience with efficiencies over a long span of time might not be particularly meaningful for current practitioners. However, C/H perform a number of simple statistical tests to determine whether there were differences in review between the first five years of the ten-year period (April 1997 through March 2002) and the last five years of the period (April 2002 through March 2007). While some differences emerged, C/H typically found no statistical difference between the two periods. Having said that, it would have been interesting to evaluate whether the revisions resulted in any differences in efficiency concerns or acceptability with the pre-1997 period.

⁹ That is not to say that the Report does not discuss those concerns, but it tends to focus on comparing the BE concerns to those of BC.

offers a decision as to the acceptability of the claims—for both Bureaus, the no-decision percentage was about 60 percent. (C/H Tables 2 and 3). While the Report does not offer an explanation of the high frequency of no-decisions, it may be that these arise in matters where the anti-competitive effects are so obviously absent or so obviously substantial that there was little reason to reach a decision concerning whether the parties established the claimed efficiencies.

To probe this low acceptance rate (my characterization) more deeply, we can rely on the data compiled by C/H. C/H categorized all of the efficiency claims into one of the following three types: “Fixed-Cost Efficiencies,” “Variable-Cost Efficiencies,” and “Other Efficiencies.” The Fixed-Cost Efficiencies category consists of five different kinds of cost savings, including overhead savings, advertising efficiencies, and research efficiencies. The Variable-Cost Efficiencies category also consists of five different kinds of cost savings, including production cost savings, distribution cost savings and best-practice efficiencies. The Other Efficiencies category consists of dynamic efficiencies and generic efficiencies. The former includes savings associated with the ability to offer better or a wider array of products, “cross-selling” synergies, and “an enhanced ability to compete.” The “generic” category is one where C/H were unable to characterize the efficiencies as variable or fixed based on the information in the memoranda.

I was surprised that the Report seemed to treat fixed cost claims with the same degree of importance as variable cost claims, since we expect that the latter are much more likely than the former to be translated into price reductions. In a note, C/H observe that the 1997 Guidelines revisions do not exclude consideration of fixed cost savings and cite the Guidelines’ Commentary for the point that fixed cost savings can have procompetitive effects in a longer-run setting. My experience has been that economists typically focus on the variable cost savings, with little or no analysis of the fixed cost savings. One exception is where the reduction in fixed costs allows the merging parties to create new product “platforms,” such as new classes of cars or drugs.¹⁰

Based on the data compiled by C/H, BC accepted about 7 percent of the fixed and variable cost claims. BE accepted 21 percent of the fixed cost claims and nearly 30 percent of the variable cost claims. (C/H Tables 2 and 3.) Thus, BE was clearly more accepting of the fixed and variable cost efficiencies than BC.

Surprisingly (to me, anyway), both Bureaus had a markedly higher acceptance rate for dynamic efficiency claims—23 percent for BC and 43 percent for BE. (C/H Tables 2 and 3.) I would have thought that the Bureaus would have been more likely to reject the dynamic efficiency claims than the variable and fixed cost efficiency claims because it seems harder to verify the former efficiency type (e.g., improved cross selling or an increased ability to offer new products) than the latter (e.g., switching production from higher to lower cost plants). It would be interesting to explore exactly why the two Bureaus were more inclined to accept what at first glance seems to be a quantitatively fuzzier type of efficiency. C/H note that that these results could suggest that the Bureaus, particularly BE, are prepared to consider the longer-run consequences of the merger.

While BE seems more accepting of efficiencies, the amount of “attention” paid to efficiencies was not much different from that of BC as judged by the percentage of the staff memoranda accounted for by the evaluation of the claimed efficiencies. That evaluation was very limited for both Bureaus. For BC, 5.2 percent of the memoranda addressed efficiencies, while for BE, the corresponding fraction was 5.8 percent, although there was substantial variation in these percentages. C/H report that for BC, there were 22 matters where the efficiency discussion accounted for

¹⁰ It is not clear whether C/H would have categorized such efficiencies as “fixed cost,” “dynamic,” or both.

1 percent or less of the memorandum and 17 where it accounted for at least 10 percent of the memorandum. The corresponding numbers for BE were 14 and 14, respectively. This suggests that for some investigations, the efficiency evaluation by the Bureau was non-trivial.

It would be interesting to know what circumstances warranted a more extensive efficiency evaluation in those matters. Some of the increased interest might be related to the nature of the ultimate enforcement action. The Report does not examine the extent to which staff recommendations on enforcement actions turned on the acceptability of the efficiency claims. However, the Report does note that the number of claims evaluated by BE and BC was as high in matters that resulted in the FTC seeking a preliminary injunction (PI) as in closed investigations.

Along these same lines, C/H note without any detail that the fraction of pages accounted for by efficiency discussions in the BC memoranda was higher for investigations leading to a PI request vs. mergers that were cleared by the agency. For BE, the intensity of the discussion was statistically the same for both types of outcomes. Thus, overall, these suggest that the role of efficiencies in investigations leading to a PI request may have some significance for that decision, and this may be true—perhaps to a lesser extent—for closed investigations.¹¹

In addition, the fraction of claims *accepted* by the Bureau was significantly higher for closed investigations than for those ending in enforcement actions (particularly a PI). For closed matters, the greater acceptance rate for the claimed efficiencies may indicate that the parties offered sufficiently credible claims that they had a role in the Bureau's recommendation not to seek an enforcement action. For BC, efficiency claims were accepted in 6.9 percent of the PI actions and 15.3 percent of the closed matters and while the corresponding acceptance rate for BE was 28 percent and 37 percent, respectively. These data also suggest that the role of efficiencies was of some significance to the outcomes of some of the merger investigations.

C/H also provide statistics on the efficiency concerns of the staff when rejecting the efficiency claims. (C/H make clear that for a claim to be categorized as “rejected,” that rejection must be unambiguous.) To conduct this evaluation, C/H categorized the reasons for the staff's concerns about the claimed efficiencies in a way that tracked the Horizontal Merger Guidelines' standards for “cognizable” efficiencies. These include whether the claimed efficiencies are verifiable, merger specific, and “valid” (i.e., not the result of anticompetitive conduct). Additional reasons included concerns about the fixed-cost nature of the savings, whether or not the efficiencies would be passed through to the consumers, and whether or not the efficiencies would occur outside of the markets of concern.¹²

Table 5 of C/H reports the reasons for rejection of the 12 different categories of efficiencies, defined above. Needless to say, with 12 different categories of efficiencies and 6 categories of rejection types,¹³ populating the 72 different cells will quickly create substantial small-numbers issues, and much more quickly with BE than BC. To reduce the scale of the small-number problems, I aggregated the 5 various fixed cost claim types into one single “fixed-cost” category, and similarly for variable costs. My aggregation is reported in Table 1 (which is based on the data con-

¹¹ For BC, the average number of pages devoted to efficiencies was 12.4 for PI matters and 5.06 for closed matters. For BE, the corresponding number of pages was 3.5 and 2.67, respectively.

¹² Since the usual concern with fixed cost savings is that they are not passed through to consumers, then presumably the pass-through concern is not related to the fixed cost concern. In addition, it is not clear what C/H mean when the Report identifies a “fixed cost” concern with a fixed cost efficiency claim. Presumably, that concern does not mean that the fixed cost savings is a variable cost savings.

¹³ The two other categories of rejection reasons—“Other” and “No Reason Specified”—did not figure into this particular analysis.

tained in C/H Table 5). C/H identify 91 fixed and variable efficiency claims that were clearly rejected by BC and 28 fixed and variable efficiency claims that were clearly rejected by BE.¹⁴

Table 1: Concerns Raised: Rejected Efficiency Claims

	FIXED COST EFFICIENCIES		VARIABLE COST EFFICIENCIES	
	BC STAFF	BE STAFF	BC STAFF	BE STAFF
Verifiability	31%	26%	39%	33%
Merger Specificity	35%	38%	41%	40%
Validity	10%	9%	0%	0%
Out of Market	8%	3%	8%	7%
Fixed Costs	6%	6%	3%	0%
Absence of Pass Through	10%	18%	8%	20%

Source: Malcolm B. Coate and Andrew J. Heimert, Merger Efficiencies at the Federal Trade Commission 1997–2007 (FTC Bureau of Economics Feb. 2009), <http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf>, Table 5.

Surprisingly, perhaps, the merger specificity concern was the single most important reason for rejection of the claims, almost equally so for both Bureaus and for both fixed and variable cost claims (35 percent–38 percent for fixed cost claims and 40 percent–41 percent for variable cost claims). (There almost certainly is no statistically significant difference between the two Bureaus on this score.) One might wonder whether the frequency of this concern might be greater in the earlier part of the ten-year period than the later part, as the FTC staff developed an approach to addressing the Guidelines merger-specificity revision. The 1997 revision of the Guidelines replaced the previous requirement that, to be counted, the claimed efficiencies cannot be “reasonably achieved by the parties through other means” to a less restrictive version requiring that the alternative means be ones that could be practically deployed by the firm, not just hypothetically.

The second most-often cited reason for rejection was the staff’s inability to verify the fixed or variable cost savings claims in an apparently convincing way. Again, both Bureaus were equally prone to reject fixed and variable cost claims on these grounds. For fixed cost claims, the rejection rate was 31 percent for BC and 26 percent for BE; the corresponding percentages for variable costs were somewhat higher, 39 percent and 33 percent, respectively. (See Table 1 above.)

Because merger specificity and verifiability dominated the reasons for rejecting fixed or variable cost claims, each of the other three categories (out-of-market efficiencies, fixed-cost efficiencies, and pass-through concerns) is plagued by a very small number of claims for both Bureaus. Consequently, one would not want to rely too heavily on the importance of these reasons for rejection, but pass-through concerns appeared to be more important for BE than BC.¹⁵

We can repeat this same exercise for claims for which the Bureaus registered concern but which neither Bureau either accepted or rejected the claims. Table 2 below is based on the C/H data reported in their Table 4. While this exercise is not likely as probative as that for rejected claims, it nonetheless can serve to highlight what is of most concern to the Bureaus. For fixed cost savings, BC expressed concerns with respect to 100 claims while BE expressed concerns with respect to 86 claims. The corresponding variable cost concerns for each Bureau were 84 and 74, respectively.

¹⁴ The small numbers issues were particularly severe for dynamic and generic efficiency claims and so I do not discuss those here.

¹⁵ As noted above, the category “dynamic” efficiency claims had even more substantial small-number issues and so I have not reported the reasons for rejecting those claims. The numbers were a bit larger for “generic” efficiency claims than for dynamic claims and the most frequent reasons for rejection tracked those for fixed and variable cost claims—merger specificity and verifiability.

In contrast to the rejected claims results, verifiability was the leading reason for concern with respect to the no-decision claims, with merger specificity coming in second. And while verifiability was the leading concern for both fixed and variable cost savings, there was some evidence that there was a seemingly greater concern for variable rather than fixed cost claims.

Table 2: Concerns Raised: No-Decision Efficiency Claims

	FIXED COST EFFICIENCIES		VARIABLE COST EFFICIENCIES		DYNAMIC COST EFFICIENCIES	
	BC STAFF	BE STAFF	BC STAFF	BE STAFF	BC STAFF	BE STAFF
Verifiability	34%	38%	43%	58%	47%	43%
Merger Specificity	21%	20%	32%	26%	35%	30%
Validity	7%	6%	2%	0%	0%	0%
Out of Market	8%	11%	6%	5%	6%	13%
Fixed Costs	12%	15%	2%	3%	0%	9%
Absence of Pass Through	18%	11%	15%	8%	12%	4%

Source: Malcolm B. Coate and Andrew J. Heimert, *Merger Efficiencies at the Federal Trade Commission 1997–2007* (FTC Bureau of Economics Feb. 2009), <http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf>, Table 5.

Verifiability accounted for 34 percent of the fixed-cost efficiency concerns of BC, while verifiability accounted for 38 percent of the BE concerns. The corresponding percentages for variable costs were 43 percent and 58 percent. These fixed-variable cost differences may simply reflect the greater scrutiny that might be given to variable costs because of the direct implications of those savings for post-merger pricing.

As with verifiability, merger specificity was of greater concern with respect to variable cost claims than for fixed cost claims. Merger specificity accounted for 32 percent of the BC variable cost concerns and for 26 percent of BE's variable cost concerns. For fixed cost concerns, the corresponding percentages were 21 percent and 20 percent respectively. Pass-through concerns seemed to be equally important for fixed and variable cost claims. For fixed-cost claims, pass-through accounted for 18 percent of the BC concerns and 11 percent of the BE concerns. The corresponding percentages for variable costs are 15 percent and 8 percent.

While concerns with “dynamic” efficiencies were subject to greater small-number problems, verifiability accounted for 47 percent of the BC concerns and 43 percent of the BE concerns—perhaps not too surprising given the typical “fuzziness” of the claims. Still, as noted above, these were the types of efficiency claims most likely to be accepted by both Bureaus. Merger specificity accounted for 35 percent of the BC concerns with dynamic efficiency claims; the corresponding percentage for BE was 30 percent.

Where possible, C/H tallied the magnitude of the efficiency claims made by the parties in the matters reviewed by C/H. On average, the claimed efficiencies amounted to about 8 percent of the value of the transaction. It would have been more useful (if the data were available) to calculate the cost savings as a fraction of total costs to determine whether 8 percent is a “large” efficiency gain. If the gross profit margin were 50 percent, then the cost savings would be about 4 percent of costs. Note that this is much lower than the illustrative 10 percent efficiency gain used in the previously cited Farrell-Shapiro paper.

What does all this suggest for the antitrust practitioner? Few efficiency claims are actually accepted by the Bureaus, and the Bureau memoranda typically spend little space on discussing those claims. I find that disappointing, although that lack of discussion may at least in part be a result of the failure of the merging parties to offer any credible defense of the claimed efficiencies.

Perhaps the extent of the Bureaus' evaluations (and the credibility of the parties' analyses) may increase with the new economic leadership at the agencies.

Nevertheless, efficiencies evidently played a key role in the merger evaluation in several matters, i.e., those matters for which 10 percent or more of the Bureau's memoranda were focused on the efficiency claims. Perhaps the ultimate prescription for practitioners is obvious: If there are no slam-dunks on responding to competitive effects concerns (e.g., entry and repositioning), then the parties need to ensure they have a strong efficiencies story to tell that will outweigh what would otherwise be a post-merger tendency to increase prices.

This is a Report that can be illuminating, but provides such a barrage of results and characterizations that it makes for dense reading, and I did not find the BC versus BE focus as the most obviously helpful way to report these results. A colleague of mine sometimes admonishes me to "admire" an empirical or analytic result that provides insight into an antitrust matter, to consider its full implications for the antitrust assessment, and to spell out those implications. C/H could have spent more time admiring their results.

One important matter that I did not address here was the extent to which concerns were registered by the Bureaus regarding specific types of fixed or variable cost efficiencies, and that alone may make the Report worth reading. For example, verifiability of advertising efficiencies was of much greater concern to both Bureau staffs than was merger specificity.

One might hope that C/H will extend their analysis to explain when the Bureaus choose to expend a relatively greater effort in evaluating the merger claims and in particular to identify the role of efficiencies in "close calls" for matters leading to either enforcement actions or the closing of the investigation. In addition, it would be useful to describe the circumstances in which fixed cost savings were an important component of the investigation, and why. ●

—JRW